Before the
Federal Communications Commission
Washington, D.C. 20554

CC Docket No. 95-60

In the Matter of

Revision to Amend Part 32, Uniform System of Accounts for Class A and Class B Telephone Companies to Raise the Expense Limit for Certain Items of Equipment from $500 to $750 — RM 8448

NOTICE OF PROPOSED RULEMAKING

Adopted: May 2, 1995; Released: May 31, 1995

Comment Date: July 24, 1995
Reply Comment Date: August 8, 1995

By the Commission:

I. INTRODUCTION

1. On March 1, 1994, the United States Telephone Association ("USTA") filed a Petition for Rulemaking to amend Section 32.2000(a)(4) of the Commission's Rules. USTA requests that Section 32.2000(a)(4) be changed to increase from $500 to $2000 the current limit for expensing, rather than capitalizing, certain items of equipment.[1] USTA also requests that carriers be permitted to amortize the previously-capitalized, undepreciated investment in such embedded equipment over the remaining life of the account in which the investment is recorded.

2. The Commission issued a Public Notice inviting comments on USTA's petition.[2] Seven parties filed comments supporting USTA's petition; one party opposed the petition.[3] Three parties filed reply comments supporting the petition.[4]

3. In this Notice of Proposed Rulemaking ("NPRM"), we propose to raise the limit for expensing certain equipment from $500 to $750. We seek comments on this proposal and on whether we should permit carriers to amortize the undepreciated, embedded assets covered by such an amendment to our rules, and, if so, over what period of time.

II. BACKGROUND

4. The expense limit that USTA proposes to raise has been increased several times in the past. It was raised from $25 to $50 in 1974,[5] from $50 to $200 in 1981,[6] and most recently, from $200 to $500 in 1988.[7] These increases in the expense limit were made primarily to recognize the effects of inflation. Other factors considered by the Commission were the increased competitive environment, rapid technological changes, and the Commission's conclusion that the accounting and administrative costs of requiring carriers to capitalize assets of low dollar value exceeded any benefit that might be realized from such capitalization.[8]

III. PETITION SUMMARY, COMMENTS AND REPLIES

5. USTA proposes that we increase the limit for expensing certain equipment set forth in Section 32.2000(a)(4) from $500 to $2000. USTA claims that the current $500 limit is no longer relevant in today's competitive environment, and no longer serves the public interest. USTA believes that raising the expense limit to $2000 will bring the accounting practices of regulated companies closer to the practices of comparable, unregulated companies. USTA also requests that carriers be permitted to amortize the embedded net book value of previously capitalized amounts in each of the accounts covered by this petition. USTA proposes that the amortization take place over the remaining asset life for each account and estimates that the amortization periods would range from three to five years.

6. All of the commenters except MCI favor USTA's petition. They set forth several arguments to support their contention that raising the expense limit would serve the public interest. These commenters argue that increasing the expense limit would: lead to decreased administrative and recordkeeping costs;[9] align the accounting practices of regulated companies with those of nonregulated companies;[10] and adjust the Commission's regulations to reflect the increasingly competitive telecommunications environment.[11] Commenters state that for LECs under price cap regula-

[1] The accounts covered by § 32.2000(a)(4) are: 2112, Motor vehicles; 2113, Aircraft; 2114, Special purpose vehicles; 2115, Garage work equipment; 2116, Other work equipment; 2122, Furniture; 2123, Office equipment; and 2124, General purpose computers.

[2] On March 23, 1994, the Commission issued a Public Notice inviting comments on USTA's petition (RM-8448).

[3] The parties that filed comments in favor are Alltel Service Corporation ("ALLTEL"), The Ameritech Operating Companies ("Ameritech"), BellSouth Telecommunications, Inc., ("BellSouth"), The Bell Atlantic Telephone Companies ("Bell Atlantic"), Pacific Bell and Nevada Bell ("Pacific/Nevada"), Roseville Telephone Company ("Roseville"), and US West Communications, Inc. ("US West"). MCI Telecommunications ("MCI") filed comments in opposition to USTA's petition.

[4] Reply comments were filed by USTA, Southwestern Bell Telephone Company ("SWBT"), and Pacific/Nevada.

[5] *See* Amendment of Part 31 (Uniform System of Accounts for Class A and Class B Telephone Companies) to increase the monetary limit where capitalization is appropriate from $25 to $50, *Report and Order,* FCC No. 74-1289, (Released Dec. 5, 1974).

[6] *See* Amendment of the Uniform System of Accounts to increase the dollar limit for expensing minor items, *Report and Order*, FCC No. 81-477, (Released Oct. 16, 1981).

[7] *See* Revision to amend Part 31, Uniform System of Accounts for Class A and Class B Telephone Companies as it relates to the treatment of certain individual items of furniture and equipment costing $500 or less, *Report and Order,* 3 FCC Rcd 4464 (1988).

[8] *Id.* at para 14.

[9] ALLTEL comments, pp. 1-2; Ameritech comments, p. 1; Bell Atlantic comments, p. 1; BellSouth comments, p. 2; Pacific/Nevada comments, p. 2; Roseville comments, p. 2; US West comments, p. 3.

[10] Ameritech comments, p. 1; Pacific/Nevada comments, p. 2; US West comments, p. 2.

[11] Roseville comments, p. 2; Pacific/Nevada comments, p. 2.

tion, the change would not increase rates, nor affect prices of regulated services.[12] Commenters also assert that the proposed change conforms better with generally accepted accounting principles[13] and allows carriers to react more quickly to rapid technological changes.[14] In addition, Bell Atlantic, Pacific/Nevada, and US West support USTA's request that carriers be permitted to amortize the embedded net book value of the undepreciated assets over the remaining life of the accounts. [15] Roseville and US West claim that this would allow the change in the expense limit to be revenue neutral.[16]

7. MCI opposes the petition. It finds no public policy reason for the Commission to grant USTA's petition. MCI questions whether the shifts of the costs to expensing resulting from the proposed rule change would, in fact, be revenue neutral. MCI states that expensing an amount rather than capitalizing it will reduce the sharing[17] obligation that price cap LECs would otherwise incur.[18]

8. In reply comments, USTA asserts that MCI's objections reflect a misunderstanding of USTA's petition. USTA reiterates its view that revenue neutrality will be achieved if the Commission adopts the amortization period requested in the petition. USTA contends that if the Commission grants the petition as proposed, carriers will amortize the embedded net book value over each company's respective remaining life. Thus, the annual amortization expense would equal the depreciation expense that would have been taken if there had been no change in the Commission's Rules.[19] USTA believes that the proposed changes will have a minimal effect, if any, on sharing obligations.[20] Reply comments of SWBT and Pacific/Nevada support the USTA petition.

IV. DISCUSSION

9. Because of inflation, the increased competitive environment, and the rapid technological changes that have occurred since the Commission last changed the expense limit in 1988, we believe that we should reexamine the accounting rules related to the expense limit. We propose, however, to raise the limit to $750 rather than $2000 as suggested by USTA. While generally agreeing in principle that the expense limit should rise, we tentatively conclude that the $2000 cap requested by USTA is excessive. Inflation is one factor to be considered in determining the expense limit; other factors include: the increasingly competitive environment, rapid changes in technology, and the fact that the limit was last changed in 1988. Since 1987, inflation rose from a base 100 to 127.0 in 1994.[21] By this measure, an item costing $500 in 1987 would cost $635 to replace with 1994 dollars. Raising the expense limit to $750 would compensate for inflation over the last seven years and, assuming no significant change in the rate of inflation, would eliminate the need to adjust the cap because of inflation for approximately five years. We also believe that by raising the expense limit above the amount indicated strictly by inflation, we recognize the increasingly competitive environment and the rapid changes in technology.

10. USTA claims that its proposal would be revenue neutral. We believe, however, that USTA's proposal only would be revenue neutral with regard to recovery of the embedded investment, but not for new purchases. If the flexible three to five year amortization period, as proposed by USTA, equals the prescribed depreciable lives of the embedded investment, which is not always the case, there will be no increase in the revenue requirement associated with the embedded investment. The amount of expense will increase, however, due to new purchases that would have been capitalized that would instead be immediately expensed. We seek comments on USTA's proposal, as well as on suggestions for alternative means of treating the net book balance in the embedded assets that are not yet fully depreciated.

11. In our Price Cap Performance Review for Local Exchange Carriers, *First Report and Order,* the Commission stated that where there is an accounting cost change, the issue of whether and to what extent that change should be treated as an exogenous cost change under price caps should be addressed in the same rulemaking proceeding.[22] The expense limit change we propose in this NPRM would not require LECs to increase their expenditures; LECs would merely be required to account for purchases costing between $500 and $750 differently, *i.e.*, LECs would expense all of those items under the proposed rule, as opposed to capitalizing those items under the existing rule. We believe that this accounting change does not affect the LECs' cash flow and thus does not represent an economic cost for the LECs. Thus, it appears that this proposed change in the USOA would not be eligible for exogenous treatment under the revised rule in the *LEC P.C. Review Order.* We seek comments on whether our proposed expense limit change is an economic cost and what effect, if any, on cash flow it may have that would qualify this accounting change for exogenous treatment.

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12 Ameritech comments, p. 2; Bell Atlantic comments, p. 1.

13 BellSouth comments, p. 2.

14 Bell Atlantic comments, p. 2.

15 Bell Atlantic comments, p. 1; Pacific/Nevada comments, p. 4; US West comments, p. 4.

16 Roseville comments, pp. 2-3; US West comments, p. 4.

17 For LECs subject to price cap regulation, sharing is a way to ensure that ratepayers share in the benefits the price cap system can produce. For example, if a LEC elects to use a productivity factor of 3.3 percent and its earnings exceed 12.25 percent rate of return, it is required to share 50 percent of the excess earnings with ratepayers. If the LEC's earnings exceed 16.25 percent, it must return 100 percent of excess earnings over the 16.25 percent level to ratepayers. If the expense limit is increased, as we propose, more items will be expensed rather than capitalized and total expenses will increase. Any increase in a price cap LEC's expenses results in a lower rate of return which could result in a reduced sharing obligation. See *Second Report and Order,* Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, 5 FCC Rcd 6786, 6801-02, paras. 120-29 (1990).

18 MCI comments, pp. 1-2.

19 USTA Reply Comments, p. 3.

20 Id.

21 GDP-Implicit Price Deflator. Source: Dept. of Commerce, Survey of Current Business.

22 *See* Price Cap Performance Review for Local Exchange Carriers, *First Report and Order,* FCC 95-132 (Released Apr. 7, 1995). ("*LEC P.C. Review Order*")

V. CONCLUSION

12. Upon consideration of the USTA petition and comments and reply comments thereon, we propose to amend Part 32 of our Rules to increase to $750 the limit that governs when certain assets may be expensed rather than capitalized, as detailed in Appendix A. In this notice we seek comments on the proposed amendment. We also seek comments on USTA's proposal to permit carriers to amortize net investment of embedded plant in accounts covered by the proposed rule changes over each company's remaining asset lives for each of those accounts.

VI. PROCEDURAL MATTERS

13. *Ex Parte Rules* - Non Restricted Proceeding. This is a non-restricted notice and comment rulemaking proceeding. *Ex Parte* presentations are permitted, provided that they are disclosed as provided in Commission Rules, except during the Sunshine Agenda period. *See generally* 47 C.F.R. Sections 1.1202, 1.1203, and 1.106(a).

14. *Regulatory Flexibility Act.* We certify that the Regulatory Flexibility Act of 1980 does not apply to this rulemaking proceeding because if the proposed rule amendments are promulgated, there will not be a significant economic impact on a substantial number of small business entities, as defined by Section 601(3) of the Regulatory Flexibility Act. Carriers providing interstate services affected by the proposed rule amendment generally are large corporations or affiliates of such corporations. Moreover, because of the nature of local exchange and access service, the Commission has concluded that small telephone companies are dominant in their fields of operation and therefore are not "small entities" as defined by that Act.[23] The Secretary shall send a copy of this NPRM, including certification, to the Chief, Counsel for Advocacy of the Small Business Administration in accordance with paragraph 603(a) of the Regulatory Flexibility Act. Pub. L. No. 96-354, 94 stat. 1164, 5 U.S.C. Section 601 *et seq* (1981).

15. *Comment Dates.* Pursuant to applicable procedures set forth in Sections 1.414 and 1.419 of the Commission's Rules, 47 C.F.R. Sections 1.414 and 1.419, interested parties may file comments on or before **July 24, 1995,** and reply comments on or before **August 8, 1995**. To file formally in this proceeding, you must file an original and five copies of all comments, reply comments, and supporting comments. If you want each Commissioner to receive a personal copy of your comments, you must file an original and nine copies. You should send comments and reply comments to Office of the Secretary, Federal Communications Commission, Washington, D.C. 20554. Parties should file one copy of any documents filed in this docket with the Commission's copy contractor, International Transcription Service, Room 140, 2100 M Street, N.W. Washington, D.C. 20037. Comments and reply comments will be available for public inspection during regular business hours in the Dockets Reference Room of the Federal Communications Commission, 1919 M Street, N.W., Washington, D.C. 20554.

16. For further information on this proceeding, contact the Accounting Systems Branch, Accounting and Audits Division, F.C.C., Room 812, 2000 L St., N.W., Washington, D.C. 20554, (202) 418-0810.

VII. ORDERING CLAUSE

17. Accordingly, IT IS ORDERED that, pursuant to Sections 4(i), 4(j) and 220 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 154(i), 154(j), and 220, NOTICE IS HEREBY GIVEN of the proposed amendment to Part 32 of the Commission's rules, 47 C.F.R. Part 32, as described in this Notice of Proposed Rulemaking. In conjunction with this notice, we delegate authority to the Chief, Common Carrier Bureau to request and obtain from the Regional Bell Operating Companies and GTE any data necessary to evaluate the possible revenue requirement impact of the proposed change.

FEDERAL COMMUNICATIONS COMMISSION

William F. Caton, Jr.

William F. Caton
Acting Secretary

APPENDIX A

47 CFR, Part 32 is proposed to be amended as follows:

Part 32 - Uniform System of Accounts for Telecommunications Companies

1. The authority citation for Part 32 continues to read as follows:

Authority: secs. 4(i), 4(j) and 220 as amended; 47 U.S.C. 154(i), 154(j) and 220 unless otherwise noted.

2. Paragraph 32.2000(a)(4) is revised to read as follows:

§ 32.2000 Instructions for telecommunications plant accounts.

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(a) ***

(4) The cost of individual items of equipment, classifiable to Accounts 2112, Motor Vehicles; 2113, Aircraft; 2114, Special Purpose Vehicles; 2115, Garage Work Equipment; 2116, Other Work Equipment; 2122, Furniture; 2123, Office Equipment; and 2124, General Purpose Computers, costing $750 or less or having a useful life less than one year shall be charged to the applicable Plant Specific Operating Expense accounts. If the aggregate investment in the items is relatively large at the time of acquisition, such amounts shall be maintained in an applicable material and supplies account until items are used.

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[23] See MTS and WATS Market Structure, 93 FCC 2d 241, 338-39 (1983).